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# **Cape Verde:** Letter of Intent and Technical Memorandum of Understanding

June 9, 2008

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LETTER OF INTENT

June 9, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington DC 20431, USA

Dear Mr. Strauss-Kahn:

1. **Discussions for the fourth review of the Policy Support Instrument (PSI) were held in Praia during March 5–19, 2008**. This letter of intent (LOI) reviews implementation to date of the Cape Verde government's reform program under the country's PSI which was approved by the IMF Executive Board in July 2006. It affirms our commitment to the policy priorities that were laid out in detail in our Memorandum of Economic and Financial Policies (MEFP) of November 2007, and describes policy developments since the third review of the PSI and prospects for the remainder of 2008 and early 2009.

2. **The government believes that the PSI program provides firm support to enforce its policies for macroeconomic stability and the exchange rate peg and promote growth.** By fostering a disciplined fiscal framework which has yielded significant fiscal consolidation in recent years, the program has achieved a large reduction in domestic debt (9 percentage points of GDP in 2007) and created the fiscal room needed to increase infrastructure spending to ease bottlenecks to growth. At the same time, the program has enabled significant buildup of official reserves, which together with the debt reduction, will enable Cape Verde to prepare for possible declines in concessional external financing following the country's graduation from Least-Developed-Country status in January 2008.

**Recent economic developments and outlook**

3. **Economic activity was strong in 2006/07 and we expect good growth in 2008/09** underpinned by further growth in tourism investment and other services, and by public infrastructure investment. Real GDP growth rate peaked at 10.8 percent in 2006 boosted by tourism, telecommunications, and construction sectors, and is estimated at about 7 percent in 2007. Real GDP growth for 2008 and 2009 is forecast to average about 6 ½ percent which takes into account the global economic slowdown. Consumer price inflation (annual average) in 2007 declined to 4.4 percent from 5.4 in 2006, despite poor rainfall and should moderate even further to trend value of 2 ½ -3 ½ percent in 2008 and 2009 in line with those of our major trading partners.

**Program performance**

4. **Performance on quantitative assessment criteria for end-December 2007 has exceeded expectations** (Table 1). In particular, the program ceiling on net domestic borrowing was observed by a wide margin reflecting continued expenditure restraint and buoyant tax revenue collections thanks to strong economic growth, improvements in tax administration, and higher-than-expected asset sales. Also, the program's international

reserves target was met by a large margin even though reserve accumulation slowed down somewhat in the final quarter of 2007 driven by slowdown in FDI inflows.

5. **The government is proceeding with the implementation of the structural measures in the program** (Table 2).

- Implementation of the structural benchmarks on the General Tax Code and Judicial Process Code was met with a five-month delay from end-December 2007 due both to longer-than-expected public consultation process to forge a consensus before submission to Parliament, as well as unanticipated technical problems that arose during the final stages of the legislative drafting. Subsequently, the government with further technical assistance from the IMF's Legal Department finalized and submitted the drafts to the Council of Ministers in May and submitted them to Parliament in June 2008. The income tax code (personal and corporate) will be aligned with the government's planned legislation on rationalizing tax incentives as part of a larger package to reduce economic distortions and make the income tax system more business friendly. Specifically, the government will examine existing tax holidays, and introduce loss and carry forward provisions and accelerated depreciation as part of rationalization of tax incentives and submit the new income tax codes to Parliament in October as part of the 2009 budget.

- On energy sector reform, the economic regulatory agency (ARE) finalized and posted on ARE's website the mechanism for setting the base utility tariffs for electricity and water (an assessment criterion under the PSI) by end-March 2008. The new tariffs were determined after a lengthy analysis of Electra's costs and efficiency gains targets. Specifically, by March 28 2008, (i) the technical specifications for the base utility tariffs was agreed upon between Electra and ARE; (ii) the details of the base tariff setting mechanism were posted on ARE's website and (iii) base tariff levels were brought in line with the agreed mechanism. However, the current fuel pricing formula is complex and not very transparent and this complicates its continuous application especially given the different cost structure of the two oil companies (Shell and Enacol). As a result, the government is working on a new fuel formula and will finalize and publish it in June 2008 (a structural benchmark for March). The delay in implementing the latter measure reflects lack of funding for a energy consultant to set up and calibrate the new pricing model and the financing only got secured in early March 2008.

- The BCV has also made progress on the structural benchmarks on financial sector reform. The PSI benchmark for June 2007 on the implementation of the recommendations of the financial-sector task force was met late 2007 with the publication of a new risk-oriented regulation, which broadly aligned the regulatory requirements for onshore and offshore banks. The benchmark for March 2008 on the establishment of the financial intelligence unit was met in January 2008, and the legislative drafting of the AML/CFT was concluded at end-March 2008.

**Economic policies for the remainder of 2008 and for 2009**

6. **The government will continue to focus on enhancing macroeconomic stability and implementing structural reforms to improve productivity growth and encourage private-sector led development.** Fiscal and monetary policies are consistent with program goals and supportive of the peg. In particular, public debt will continue to come down as a share of GDP and international reserves are expected to buildup further. The 2008 program aims at promoting structural reforms especially in fiscal accounting, budget execution and control, and arrears prevention, as well as strengthening of the financial sector and improving energy sector regulation.

**Fiscal and Public Financial Management issues**

7. **Continued fiscal consolidation remains crucial to our macroeconomic program and the 2008 budget aims at a further sizable reduction of the domestic debt-to-GDP ratio.**

- The budget projections for revenues and expenditures are prudent, with tax revenues and the wage bill planned to grow by less than nominal GDP relative to the 2007 budget. As the 2008 budget does not plan additional net domestic borrowing in 2008, the net domestic debt-to-GDP ratio is projected to continue to decline below 20 percent by end-2008, with the original target reached two years ahead of schedule. Going forward, we are committed to continue to reduce public debt as a share of GDP and to keep it on an appropriate path consistent with the medium term baseline debt path agreed with the IMF. Using our medium-term fiscal framework, we are considering increasing capital expenditure modestly to ease infrastructure bottlenecks for both transportation and the energy sector. Consistent with the government's overall investment program, our planned increases in capital spending, which also recognizes the need for a comprehensive overhaul of the energy sector, will be in line with the strengthening of our public financial management (PFM) and debt management.

- The rationalization of tax incentives is also a high priority to the government since it will improve procedures to grant exemptions and repeal some of the current exemptions. Reforming the corporate income tax rate will help to muster public support for rationalizing tax exemptions. To this end, we reiterate our request for technical assistance to the IMF to help us with a framework which will underpin the economic criteria for rationalizing tax incentives.

8. **The government remains fully committed to moving ahead with its program of strengthening public sector financial management as outlined in our MEFP for the third review of the PSI**. Thus, we agreed to include a new structural measure in the program which will submit a simplified medium-term fiscal framework to the Council of Ministers in the 2009 budget preparation cycle and publish it on the Ministry of Finance website in November 2008 to help to anchor fiscal policy on a medium-term perspective. This measure will help the government to build capacity for formulation of a medium-term fiscal policy, lay the basis for implementation of a medium-term expenditure framework (MTEF), program budgeting and a medium-term investment program (MTIP) in line with the forthcoming PRSP-II for 2008-11.

9. **Strengthening our debt management capacity is also a high priority**. At present our debt management office has a number of resource constraints. A strengthened debt management strategy will underpin the government's borrowing program and the country's overall medium-term fiscal framework. In this context, the government reiterates its need for technical assistance from the IMF to strengthen debt management, which could include assistance to enhance our asset-liability management. On concessional financing, the government has extensively reached out through its various donor partners, including through several high level conferences to shore up concessional financing over the medium term. Most donors have responded positively by confirming that graduation from the UN's Least Developed Country status will not lead to an abrupt end to concessional aid. Thus, we will continue to look for concessional money to finance our planned increases in infrastructure spending. In line with our plans to strengthen our debt management office and strategy, the government will review thoroughly with the IMF the borrowing necessary to finance vital projects to ease infrastructure constraints on growth and help to decisively move ahead with the much needed reform of the energy sector.

**Monetary and financial sector issues**

10. **Monetary management remains consistent with the program goal of building up foreign exchange reserves to support the peg to the Euro**. Consistent with the exchange rate peg, the Bank of Cape Verde (BCV) will continue to adjust domestic interest rates in the short run to smooth out capital flows. The BCV's official policy rate will remain the interest rate offered on the 14-day bill. The government's objective is to increase reserves by about 0.1 month of prospective imports annually reaching over 4 months by 2013.

11. **The BCV is strengthening the regulation and supervision of the financial sector**.

- All four onshore banks are fully compliant with the new strengthened prudential requirements. New bank regulations on capital ratios, provisioning and loan classification, credit risk assessment, and credit concentration were published in November 2007 and BCV has given banks a 5 year transitional period to meet the new requirement on provisions on non-performing loans. To further financial sector stability, the BCV agrees to a new structural benchmark to be included in the program which will establish a system to enhance the monitoring of external flows including non-resident deposits. Better monitoring of deposits is necessary to promptly detect potentially destabilizing capital flows and adjust interest rates as necessary to smooth out these capital flows. We will continue to study to what extent these deposits (or subsamples of these deposits) are interest sensitive.

- A new insurance sector regulation is being modernized to cover both life and non-life aspects of the insurance industry. Although the basic infrastructure on capital markets is in place, the operational and legal aspects are not yet fully developed and modernized including the Securities Code and the Company's Act. As a result, the capital market needs to be better oriented toward supporting economic development in Cape Verde. The government recognizes that the development of capital markets will enable domestic companies access funds from emigrants seeking investment opportunities other than emigrant deposits and is consistent with turning Cape Verde into an international financial centre. Thus, the government is working on these aspects, and will take further measures to minimize risks to the financial system before moving further with liberalization of financial flows.

**Energy sector reform**

12. **Despite the resource constraints that have caused delays in implementing the government's comprehensive plans to reform the energy sector, the reforms are steadily moving in the right direction.** Following the approval of the new base utility tariff mechanism, there will be regular adjustment of these tariffs, which will ease Electra's cash flow problems, clear its arrears with suppliers, help the implementation of its investment plan, and stop the accrual of tariff deficits, a government contingent liability. Thus, consistent with the government's commitment in the MEFP for the 3rd review of the PSI not to allow subsidies for energy products in the 2008 budget, ARE adjusted fuel prices by end-March 2008. A new simplified and more transparent fuel pricing formula is also being prepared to be finalized and published in June 2008. One consideration is to base the new fuel formula on international benchmark prices, which will stop the accrual of fuel price deficits owed to the oil companies, and will be in line with the joint venture for the two oil suppliers into a joint logistics company to handle importation, storage and inter-island distribution of oil products by July 2008. As part of early deliverables on Electra's reform, Electra will also strengthen its revenue collection system, including putting in place prepaid meters. To provide financial assistance to Electra, with the help of donor assistance, the government will build five power plants and lend them on to Electra. The government is also considering management contracts with the private sector to improve Electra's management. We also recognize the potential role of public private partnerships (PPP) to boost investments in the energy sector; and will therefore strengthen the regulation for PPPs to ensure that the risk-sharing arrangement in these PPP prevents any contingent liability for the government in the future.

**Program monitoring and reporting**

13. **Under the PSI, the government will keep the IMF regularly updated on economic and policy developments and will provide the data needed for adequate monitoring of the program**. This extended LOI provides updates to our MEFP of November 2007 as follows: Program's quantitative targets for the end-June 2008 were reviewed and affirmed and targets were set for end-December 2008 (Table 1), and two new structural measures on public financial management and the financial sector in the program were included (Table 2). The fifth and sixth reviews of the PSI are scheduled to be completed by end-October 2008 and end-April 2009, respectively. During the period of the PSI, Cape Verde will consult with the IMF on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the IMF requests such a consultation.

14. We authorize the IMF to publish this letter, and the related staff report and selected issues papers.

Sincerely yours,

/s/
Cristina Duarte
Minister of Finance and Public Administration.

Table 1. Cape Verde: Quantitative Assessment Criteria and Benchmarks for 2007-08 Under the PSI [1, 2]

| | Cumulative Flows from End-December, 2006 2007 | | | | Cumulative Flows from End-December, 2007 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | Dec. | | | | March | June | Sep. | Dec. |
| | Assessment Criteria | Assessment Criteria with adjusters | Actual | Level Actual | Indicative Target | Assessment Criteria | Indicative Target | Assessment Criteria |
| **Quantitative targets** | (Billions of Cape Verde escudos) | | | | | | | |
| Ceiling on net domestic borrowing of the central government [3] | -3.9 | -3.7 | -5.7 | ... | -0.4 | -0.8 | -1.3 | -1.7 |
| Ceiling on net domestic assets of the central bank [4] | -3.0 | -3.2 | -5.1 | -3.6 | -0.6 | -1.3 | -2.0 | -2.5 |
| Ceiling on the accumulation of new domestic payment arrears by the central government | 0.0 | 0.0 | 0.0 | ... | 0.0 | 0.0 | 0.0 | 0.0 |
| | (Millions of U.S. dollars) | | | | | | | |
| Ceiling on the accumulation of new external payment arrears by the central government [5] | 0.0 | 0.0 | 0.0 | … | 0.0 | 0.0 | 0.0 | 0.0 |
| Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government [6] | 35.0 | 35.0 | 0.1 | ... | 5.0 | 21.0 | 28.0 | 35.0 |
| Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year by the central government [5,7] | 0.0 | 0.0 | 0.0 | … | 0.0 | 0.0 | 0.0 | 0.0 |
| | (Millions of euros) | | | | | | | |
| Floor on net international reserves of the Bank of Cape Verde (BCV) [8] | 41.2 | 43.0 | 53.0 | 248.6 | 12.6 | 25.3 | 36.8 | 50.6 |
| *Memorandum item:* | (Billions of Cape Verde escudos) | | | | | | | |
| **Program assumptions** | | | | | | | | |
| Nonproject external financial assistance, including credit line (program assumption) | 3.0 | ... | 2.9 | ... | 0.6 | 1.2 | 1.8 | 2.4 |
| External debt service | 2.6 | ... | 2.3 | ... | 0.7 | 1.3 | 2.0 | 2.6 |
| Land sales | 2.0 | ... | 1.6 | ... | 0.7 | 1.4 | 2.1 | 2.8 |
| Clearance of end-2006 stock of domestic arrears | 1.0 | ... | 1.3 | ... | 0.4 | 0.8 | 1.1 | 1.5 |

[1] Quantitative assessment criteria and benchmarks are described in the technical memorandum of understanding.

[2] For purposes of calculating program adjusters, foreign currency amounts will be converted at current exchange rates.

[3] Excluding borrowing for clearance of arrears and net late payments. The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service, and upward (downward) by the cumulative downward (upward) deviation in nonproject external financial assistance and land sales relative to program assumptions.

[4] The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviation in nonproject external financial assistance relative to program assumptions.

[5] This assessment criterion is on a continuous basis.

[6] This assessment criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.

[7] The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.

[8] The floor on net international reserves of the Bank of Cape Verde will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service, and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions.

**2. Cape Verde: Structural Assessment Criteria and Benchmarks for 2007–08**[1]

| Objectives | Conditionality | Timing | Status |
|---|---|---|---|
| | **Structural Assessment Criteria** | | |
| Reduce fiscal risks | Fully apply mechanisms for setting and adjusting electricity, water, and fuel prices (LOI ¶12). | Continuous[2] | Not met |
| Reduce fiscal risks | Finalize and publish the mechanism for setting base utility tariffs (LOI ¶5). | End-March 2008 | Met |
| Improve fiscal policy execution | Complete a formal mid-year review of revenue and expenditure developments that allows for taking corrective actions if necessary. | End-August 2008 | |
| | **Structural Benchmarks** | | |
| Improve budget control | Instituting November 30 as deadline for granting new spending commitments to reduce end year payment pressure. | End-October 2007 | Met |
| Strengthen tax administration | Finalize reform strategy for the General Tax Directorate (DGCI). | End-Dec. 2007 | Met |
| Strengthen the tax base | Submit the new General Tax Code to the National Assembly (LOI ¶5). | End-Dec. 2007 | To be implemented in June 2008 [3] |
| Strengthen the tax base | Submit the new Code on Judicial Process to the National Assembly (LOI ¶5). | End-Dec. 2007 | To be implemented in June 2008 [3] |
| Strengthen the tax base | Submit the draft individual and corporate income tax bills to the National Assembly (LOI ¶5). | End-Dec. 2007 | Postponed to October 2008 (LOI ¶5) |
| Reduce fiscal risks | Finalize and publish a revised mechanism for adjusting petroleum prices (LOI ¶12). | End-March 2008 | To be implemented in June 2008 |
| Strengthen financial supervision | Submit to the National Assembly legislation to establish a Financial Intelligence Unit (LOI ¶5). | End-March 2008 | Met |
| Strengthen financial regulation | Submit to the National Assembly legislation to criminalize financing of terrorism and facilitate the combating of financing of terrorism (LOI ¶5). | End-March 2008 | To be implemented in June 2008 [3] |
| Strengthen financial regulation | Submit to the National Assembly legislation to strengthen the framework for combating money laundering (LOI ¶5). | End-March 2008 | To be implemented in June 2008 [3] |
| | **New Structural Benchmarks introduced during the 4th PSI review** | | |
| Promote domestic and external stability | Submit a simplified medium-term fiscal framework (MTFF)[4] to the Council of Ministers in the 2009 budget preparation cycle and publish it on the Ministry of Finance website (LOI ¶8). | November 2008 | |

| | | |
|---|---|---|
| Promote financial stability | Prepare a quarterly report on developments on balance of payments flows, including an assessment of interest sensitivity of non-resident flows into the banking system (LOI ¶11). | December 2008 |

[1] Updated during the 4th PSI review.

[2] Through end-May 2008, following the coming into effect of the new base utilities tariffs and fuel price mechanisms.

[3] Submitted to the Council of Ministers in May 2008.

[4] The simplified MTFF will specify the annual revenues, expenditures, domestic financing, and external financing for the next three years.

## TECHNICAL MEMORANDUM OF UNDERSTANDING[1]

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of assessment criteria and indicative targets and reporting requirements for the fifth and sixth reviews under the Policy Support Instrument.

## I. QUANTITATIVE ASSESSMENT CRITERIA AND INDICATIVE TARGETS

### A. Net Domestic Borrowing Excluding for Clearance of Arrears and Net Late Payments

2. **Net domestic borrowing excluding for clearance of arrears and net late payments** is defined as the cumulative change since the start of the calendar year of the net credit to the central government from the banking and nonbanking sectors less (1) the cumulative clearance during the calendar year of the stock of arrears as of the end of the previous year and (2) the cumulative payments during the first three months of the calendar year of expenses authorized by the previous year's budget, and plus the expenses accrued during the current year that will be paid during the first three months of the next calendar year as provisioned for in the budget law (late payments or *atrasados*). The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance and land sales relative to program assumptions.

3. **Net credit to the central government from the banking and nonbanking system** is defined as the overall position of the main central government institutions vis-à-vis the banking and nonbanking system—that is, the stock of all outstanding claims on the central government (loans, advances), and all other government debt instruments, such as long-term government securities) held by the central bank, commercial banks, and nonbank institutions, less all deposits held by the central government with the central bank and with commercial banks. The INPS is not included in central government accounts. Net credit to the central government excludes claims on the Trust Fund (TCMFs).

4. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Public Administration will be provided on a quarterly basis, to be submitted not later than five weeks after the end of each quarter, including (i) government domestic revenue by category; (ii) external budget support grants; (iii) government expenditure, including primary current expenditure, domestic and external interest payments, and capital expenditure, including domestically and budget support financed capital expenditure and estimates of externally project financed capital expenditure; (iv) the gross payment and gross accumulation of domestic accounts payable (*atrasados*); (v) the gross payment and gross accumulation of domestic payments arrears; (vi) external loan receipts

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[1] Updated from the Country Report No. 08/37. Changes to paragraphs 2, 18, and 19.

and principal payments; (vii) external arrears payments and accumulation; (viii) bank and nonbank financing; (ix) privatization and land sale receipts; and (x) any other revenue, expenditure, or financing not included above.

5. For the purposes of this memorandum, privatization and land proceeds will be understood to mean all monies received by the government from the sale or concessioning of a public company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the sale of government land and the liquidation of a public company, less restructuring costs.

## B. Net Domestic Assets of the Central Bank

6. The ceiling on the cumulative change, from the beginning of calendar-year 2006, in net domestic assets of the BCV constitutes an assessment criterion. Net domestic assets (NDA) of the BCV are defined as reserve money minus net foreign assets of the BCV, evaluated at the current end-of-period exchange rates. The program ceilings for NDA will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. Reserve money comprises bank reserves and deposits of the monetary institutions and private sector with the central bank, as well as cash in circulation.

7. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

## C. Ceiling on Nonconcessional External Debt Contracted or Guaranteed by the Central Government

8. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute assessment criteria. The ceiling on medium- and long-term nonconcessional external debt is on a quarterly basis while the one on short-term nonconcessional external debt is on a continuous basis. Nonconcessional external debt is defined as debt contracted or guaranteed by the central government with a grant element of less than 35 percent, calculated using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Debt rescheduling and debt reorganization are excluded from the limits on nonconcessional external debt. The limits on new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) are specified in Table 1 of the Letter of Intent. The definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in

support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. The assessment criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the assessment criterion on short-term nonconcessional external indebtedness, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

9. **Reporting requirements.** The government of Cape Verde will consult with Fund staff before assuming any liabilities in circumstances where they are uncertain whether the instrument in question falls under the assessment criterion. Details of all new external debt (including government guarantees), indicating terms of debt and creditors, will be provided on a quarterly basis within five weeks of the end of each quarter.

### D. Net International Reserves of the Central Bank

10. The floor on the cumulative change, from the beginning of calendar-year 2006, in net international reserves (NIR) of the BCV constitutes a assessment criterion under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its external reserve liabilities, calculated at the current exchange rates. Gross reserves of the BCV are those that are readily available (i.e., liquid and marketable and free of any pledges or encumbrances), controlled by the BCV and held for the purposes of meeting balance of payments needs and intervening in foreign exchange markets. They include gold, holdings of SDRs, the reserve position at the IMF, holdings of foreign exchange and traveler's checks, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. External liabilities of the BCV comprise liabilities to nonresidents contracted by the BCV with an original maturity of less than a year, any net off-balance-sheet position of the BCV (futures, forwards, swaps, or options) with either resident and nonresidents, any arrears on principal and interest to external creditors and suppliers, and purchases from the IMF. The program floors for the NIR will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

11. **Reporting requirements.** A table on the NIR prepared by the BCV will be transmitted on weekly basis, with a maximum delay of two weeks.

### E. Nonaccumulation of New Domestic Payments Arrears

12. As part of the program, the government will not accumulate any new domestic payments arrears. This will be monitored through the monthly execution of the cash-flow

plan and the corresponding release of budget appropriations. For programming purposes, a domestic payment obligation to suppliers is deemed to be in arrears if it has not been paid within the normal grace period of 60 days (30 days for government salaries and debt service) or such other period either specified by the budget law or contractually agreed with the supplier after the verified delivery of the concerned goods and services, unless the amount or the timing of the payment is subject to good faith negotiations between the government and the creditor.

13. **Reporting requirements.** The Ministry of Finance and Public Administration, through the D.G.T., will submit on a quarterly basis a detailed table of the stock of domestic payments arrears, including the accumulation, payment, rescheduling and write-off of domestic payments arrears during the quarter. The data are to be provided within four weeks after the end of the quarter.

### F. Nonaccumulation of External Payments Arrears

14. As part of the program, the government will not accumulate any new external payments arrears on a continuous basis. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations.

15. External arrears are defined as total external debt-service obligations of the government that have not been paid by the time they are due, except where agreements between the government and creditors explicitly provide for a grace period after such obligations falling due. External arrears exclude arrears on external debt, pending the conclusion of debt-rescheduling agreements.

16. **Reporting requirements.** Data on (i) debt-service payments; and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the Ministry of Finance and Public Administration, within five weeks of the end of each quarter. In addition, the government will inform the Fund staff immediately of any accumulation of external arrears.

## II. STRUCTURAL ASSESSMENT CRITERIA[2]

### A. Finalize and publish the mechanism for setting base utility tariffs

17. The condition for finalizing and publishing the mechanism for setting base electricity and water tariffs will be deemed complete when (i) the technical specifications have been agreed upon between Electra and the autonomous Economic Regulatory Authority (ARE); (ii) the details of the base tariff setting mechanism have been published; and (iii) base tariff levels are brought in line with the agreed mechanism.

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[2] See Table 2 of the Letter of Intent of June 2008.

### B. Continuous application of the mechanisms for setting and adjusting electricity, water, and fuel prices

18. The condition will be deemed met when (i) base utility tariffs are set, and reset with the periodicity, as specified in the agreed base tariff setting mechanism; (ii) between resetting of base tariffs, utility tariffs are adjusted whenever input costs since the last adjustment have changed cumulatively by more than three percent as specified in the published utility tariff adjustment mechanism; and (iii) within one month of each import shipment of petroleum products, retail petroleum product prices are adjusted and brought in line with the specifications in the retail petroleum price adjustment mechanism. This structural assessment criterion applies continuously only through end-May 2008, after which the new base utility tariffs and fuel price mechanisms will come into effect.

### C. Complete a formal mid-year review of revenue and expenditure that allows for taking corrective measures if necessary

19. This condition will be deemed met when (i) revenue, expenditure, and financing during January–June are assessed and compared with budget forecasts; and (ii) the necessary corrective actions, if any, are identified.

## III. OTHER DATA REQUIREMENTS FOR PROGRAM-MONITORING PURPOSES

20. Data on exports and imports, including volume and prices and compiled by the Director of Customs and the BCV, will be transmitted on a quarterly basis within five weeks after the end of each quarter. A preliminary quarterly balance of payments, compiled by the BCV, will be forwarded within five weeks after the end of each quarter.